

# RatingsDirect®

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## Summary:

## Seattle; Water/Sewer

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## Table Of Contents

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Rationale

Outlook

Related Criteria And Research

## Summary:

# Seattle; Water/Sewer

### Credit Profile

US\$140.475 mil drainage and wastewtr imp and rfdg rev bnds ser 2014 due 05/01/2044

|                         |            |     |
|-------------------------|------------|-----|
| <i>Long Term Rating</i> | AA+/Stable | New |
|-------------------------|------------|-----|

Seattle drainage & wastewtr (AGM)

|                          |                  |          |
|--------------------------|------------------|----------|
| <i>Unenhanced Rating</i> | AA+(SPUR)/Stable | Affirmed |
|--------------------------|------------------|----------|

Seattle Drainage & Wastewater rev & rfdg bnds ser 2008 due 06/01/2038

|                         |            |          |
|-------------------------|------------|----------|
| <i>Long Term Rating</i> | AA+/Stable | Affirmed |
|-------------------------|------------|----------|

#### Seattle drainage & wastwtr bnds

|                          |                  |          |
|--------------------------|------------------|----------|
| <i>Unenhanced Rating</i> | AA+(SPUR)/Stable | Affirmed |
|--------------------------|------------------|----------|

Many issues are enhanced by bond insurance.

## Rationale

Standard & Poor's Ratings Services assigned its 'AA+' long-term rating to Seattle, Wash.'s series 2014 drainage and wastewater improvement and refunding revenue bonds. At the same time, Standard & Poor's affirmed its 'AA+' long-term rating and underlying rating (SPUR) on Seattle's existing drainage and wastewater system parity debt. The outlook on all ratings is stable.

The rating is based on our view of the drainage and wastewater system's:

- Stable customer base in the deep and diverse Seattle-area economy;
- Strong debt service coverage over the past three years, and
- History of adopting rate increases to support stable financial performance and to offset increases in wholesale treatment rates.

These strengths are partly offset by our view of the system's:

- Liquidity position, which at times has been low for the 'AA+' rating although it has increased in recent years, and
- Relatively large capital plan aimed in part at reducing overflows from its combined sewer and storm water systems.

The series 2014 bonds are being issued to provide \$113 million in capital funding and to refund a portion of the system's series 2004 bonds and series 2006 bonds outstanding.

The bonds are secured by a pledge of net revenues of the city's drainage and wastewater system. Additionally securing all parity bonds is a reserve, funded at the lesser of maximum annual debt service (MADS), 125% of average annual debt service, or 10% of proceeds. A rate covenant requires the system to generate coverage of 1.25 times (x) average annual debt service although withdrawals from a rate stabilization fund can be included in this calculation. At year-end 2013, the system had \$525 million in revenue bonds outstanding plus \$16 million in subordinate state loans.

The drainage and wastewater system is operated by Seattle Public Utilities, a department of the city. The system provides wastewater services to about 166,000 accounts within Seattle. The drainage system serves about 213,000 accounts. The city sits at the center of the large, diverse Puget Sound regional economy. Income levels within the city are above average, with the median effective household buying income at 121% of the national average.

The wastewater system is primarily a collection system, with all sewage treated on a wholesale basis by King County's regional wastewater treatment system. The agreement between Seattle and the county to provide wholesale sewage treatment expires in 2036 although negotiations are underway to extend the agreement. The system pays a monthly sewer charge to the county based on the number of residential customer equivalents (RCEs). Seattle is the largest customer of the regional system, representing 40% of total regional system RCEs. The county has regularly increased its wholesale rate, and the city has historically passed the increase through to its retail customers. Wholesale treatment costs are a major portion of the system's operating expenses, representing 55% of total expenses in 2013.

The drainage system consists of facilities to handle storm water runoff. Runoff is conveyed through storm drains for about a third of the city, a combined storm water and wastewater system for a third, and through a ditch, culvert, and creek system for the remaining third.

About two-thirds of the system is a combined or partly combined storm water and wastewater system. This type of system leads to heavy flows and potential system overflows during wet weather events. The city has invested heavily during the past 40 years in projects to control combined sewer overflows. Under a consent decree between the city, state, and federal government, the city is required to develop plans, programs, and infrastructure to further reduce overflows. Combined sewer overflow projects represent about 35% of planned capital spending, or \$260 million, from 2013 through 2019.

Most sewer customers are billed bi-monthly based on water consumption (winter water consumption for residential customers). A customer using 1,000 cubic feet per month would pay \$117.50. The city uses a lower 430 cubic feet per month measure for a typical residential bill, leading to \$50.53 per month. The city has increased wastewater rates in each of the past six years to cover increasing system costs and to pass through wholesale treatment costs. Storm water charges are based on parcel size and, for larger parcels, the proportion that is impervious surface. The charge is billed on the county property tax statement. For 2014, a typical residential customer's annual charge is \$319, or the equivalent of \$27 per month. The city collects wastewater rates on the same bill as water and can shut off water service for nonpayment. Unpaid storm water charges become a lien on customer's property.

The drainage and wastewater system's financial performance has been relatively stable during the past three years. Regular rate increases have helped increase operating revenue and offset increasing wholesale treatment expenses. In 2013, operating revenue totaled \$333.8 million, up 9.8% from 2012. Operating expenses excluding depreciation and taxes paid to the city were up 6.4% in 2013, at \$215.2 million, partly due to a wholesale rate increase. City taxes, which under city charter are paid only after debt service is covered, were another \$38.9 million in 2013. Senior-lien debt service coverage was strong at 2.99x in 2013, up from 2.83x in 2012, as calculated by Standard & Poor's. Coverage of total debt service, including subordinate state loans, was also strong in 2013 at 2.90x. Fixed-charge coverage, with city taxes deducted from net revenues available, was 1.99x in 2013.

In the city's projections, senior-lien coverage stays above 2x in 2014 and 2015, and fixed-charge coverage is at or above 1.2x. We view the projections as reasonable, with revenue growth based on planned rate increases and assumed increases in system expenses and wholesale treatment expenses.

In the past, the city has maintained unrestricted cash and investments in the drainage and wastewater fund at a level we view as adequate but low for the 'AA+' rating although liquidity has improved during the past two years to a level we view as strong. As of Dec. 31, 2013, unrestricted cash and investments totaled \$74.5 million, representing about 126 days of operating expenses on hand. This is a significant increase over 2011 year-end cash of 53 days. We understand the city plans to spend a portion of the current cash balance for capital projects. While liquidity has fluctuated in recent years, the system does have access to the city's \$1.4 billion pooled investments if needed. Under the city's municipal code, the finance director is permitted to make interfund loans for up to 90 days. Longer-term loans require city council approval.

The system's six-year capital improvement program (CIP) for years 2014 through 2019 covers \$646 million in projects. In addition to projects to reduce combined sewer overflows, the CIP includes rehabilitation projects, flooding and sewer-backup prevention, and other projects. The series 2014 issue is providing about \$113 million for the program. The city currently plans to issue another \$301 million in bonds over the next six years for additional funding. Other sources include prior bond proceeds, grants, and internally generated funds.

## Outlook

The stable outlook reflects our anticipation that the system will continue to provide good-to-strong debt service coverage, generate sufficient capital funding, and maintain adequate-to-good liquidity. With the past fluctuation in liquidity, we do not anticipate raising the rating during the next two years. If liquidity is drawn down to a level we view as low for the rating category and we believe the system will sustain a low liquidity level going forward, we could lower the rating.

## Related Criteria And Research

### Related Criteria

- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008
- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008

### Related Research

U.S. State And Local Government Credit Conditions Forecast, April 7, 2014

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